Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1660

S. WILLIAM GREEN, EVELYN GREEN and CYNTHIA COLIN, as Executors of the Estate of LOUIS A. GREEN, deceased, and EVELYN GREEN, individually, and as stockholders of KIRBY LUMBER CORPORATION, suing on behalf of themselves and for the benefit of said corporation and for the class of all other stockholders of said corporation similarly situated,

Petitioners,

v.

SANTA FE INDUSTRIES, INC., SANTA FE NATURAL RESOURCES, INC., KIRBY LUMBER CORPORATION, and MORGAN STANLEY & Co.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Question Presented

In an action involving a short-form merger, does the mere conclusory allegation that an investment banking firm's opinion knowingly undervalued the stock of the

merged corporation state a claim that the firm aided and abetted an alleged violation of the Federal Securities laws by the defendant corporation?

Statute and Rule Involved

Involved herein are Section 10(b) of the Securities Exchange Act of 1934, 15 USC § 78j(b) and Securities and Exchange Commission Rule 10b-5, 17 CFR 240. 10b-5.

Statement of the Case

Material Facts

The undisputed facts are as follows: plaintiffs herein were minority shareholders of Kirby Lumber Corporation ("Kirby"), a Delaware corporation engaging in the manufacture of plywood, lumber and related products and owning various timber and mineral resources in Texas and Louisiana. For some years prior to the transactions here involved, approximately 95% of the capital stock of Kirby was owned by defendant Santa Fe Natural Resources, Inc. ("Resources"), which in turn is a wholly-owned subsidiary of defendant Santa Fe Industries, Inc. ("Santa Fe"). (Petition, at A-8-9)*

In 1974 Resources exercised its right to effect a short-form merger of Kirby into Santa Fe pursuant to Section 253 of the Delaware General Corporation Law. That law permits a parent corporation owning at least 90% of the capital stock of a subsidiary to merge the parent and sub-

* Citations to "Petition, at " are to plaintiffs' Petition for a Writ of Certiorari, No. 75-1660.

sidiary, upon approval by the parent's board of directors and stockholders. A resolution of merger under Section 253 may provide that all shares held by minority stockholders will be purchased for cash; by the terms of the statute, neither consent of the minority stockholders, nor advance notice of the merger to them, is required. Any minority shareholder who is dissatisfied with the cash valuation of his shares may commence an action for appraisal in the Delaware Court of Chancery. Delaware General Corporation Law, §§ 253, 262.* (*Id.*, at A-9)

To implement the short-form merger, Forest Products, Inc. ("FPI") was organized in July 1974 as a Delaware corporation. Shortly thereafter, Resources transferred to FPI approximately 95% of the capital stock of Kirby, together with cash and the assumption of certain liabilities, in exchange for all of FPI's capital stock. FPI, a wholly-owned subsidiary of Resources, thus became the 95% owner of Kirby. (*Id.*)

In connection with the short-form merger, Santa Fe requested Morgan Stanley & Co. ("Morgan Stanley") to furnish an opinion as to the then present fair market value of a share of Kirby. Pursuant to this request Morgan Stanley made a study of Kirby's business. The result of Morgan Stanley's detailed analysis of Kirby's business was presented in a letter dated June 24, 1974 to John C. Davis, Vice President of Santa Fe in which Morgan Stanley concluded:

* The Delaware Statute was amended on April 24, 1976. The amendments, which provide further procedural rights for stockholders seeking appraisal, do not affect the issues in this case.

> Based on our studies as outlined above, and on the assumption that (i) the shares of Kirby were broadly distributed and freely traded such that willing buyers and willing sellers could readily effect transactions and (ii) the shares were split so that they would trade within the range of prices typical for many publicly-held companies, we are of the opinion that, under current market conditions, the price at which Kirby stock would trade would be the equivalent of $125 a share.*

Thereafter, the board of FPI adopted a resolution of merger pursuant to Section 253 of the Delaware Corporation Law, providing that FPI would be merged into Kirby, with Kirby as the surviving corporation. The resolution provided that the shareholders of Kirby other than FPI would have the right to receive $150 per share in cash or to seek appraisal for their stock, as permitted by the Delaware statute. The steps necessary to effect the merger under the Delaware statute were completed and the merger became effective on July 31, 1974. (Petition, at A-9) Subsequently, on August 1, 1974, the minority shareholders of Kirby were notified of the merger and advised that they had the right to receive $150 per share in cash or to seek appraisal for such shares under the applicable Delaware statute. (*Id.*, at A-62)

A lengthy and detailed information statement regarding Kirby, the Morgan Stanley opinion, and the notice were sent to the minority shareholders. (*Id.*) The statement contained substantial financial data about Kirby as well as:

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* The text of Morgan Stanley's letter appears in full at Petition, A-20-21 n.8.

> 1. an appraisal of Kirby's land, timber, buildings and machinery conducted by Appraisal Associates of Kansas City, Missouri (Resources Management Services, Inc., a firm of professional foresters, assisted Appraisal Associates by preparing an updated inventory of the Kirby forests); and
>
> 2. an appraisal of Kirby's oil and gas royalty interests and Kirby's ownership in mineral properties by Riggs and Associates, a firm of petroleum reservoir consultants.

Plaintiffs have not alleged any misrepresentation or nondisclosure in that information statement; on the contrary, the factual allegations of the amended complaint are based entirely upon the disclosures contained therein. In particular, plaintiffs' claim that the Morgan Stanley opinion is fraudulent is based solely on the fact that the information statement reported the book value of Kirby's assets to be $320,000,000 (which would yield a *pro rata* value of $772 per share).

None of the plaintiffs has tendered any of the stock of Kirby. On August 21, 1974 the plaintiffs made a demand for appraisal of their Kirby stock. On September 9, 1974 they purported to withdraw their demand for a statutory appraisal. Both of these events antedated the filing of the complaint on September 10, 1974. (*Id.*, at A-9-10)

The essence of plaintiffs' complaint is that the short-form merger allegedly resulted in the acquisition of the minority shares at a grossly undervalued price, and that this constituted a breach of fiduciary obligation owed to Kirby and its minority stockholders by the defendant corporations which violated the federal securities acts, specifically Rule 10b-5. The only allegation against Morgan Stanley

in the amended complaint asserts that Morgan Stanley was an accessory to the corporate principals in that it "knowingly assisted and facilitated such fraud by submitting an appraisal of the stock at $125 per share even though said defendant knew the pro rata value of the physical assets of Kirby was at least $772 per share." (*Id.*, at 8)

The District Court's Opinion

The United States District Court for the Southern District of New York (Breiant *J.*) held that: "Accepting plaintiffs' valuation, the amended complaint, upon its face, fails to allege a course of fraudulent conduct." (Petition, at A-64). Noting that the plaintiffs acknowledged that their allegations were based upon information provided by the corporate defendants in the merger information statement, and that the opinion rendered by Morgan Stanley detailed the information upon which it relied in computing the value of the minority's shares (*Id.*), the Court asserted that: "At least, if full and fair disclosure is made, transactions eliminating minority interests are beyond the purview of Rule 10b-5." (Petition, at A-65)

Since the Court held that plaintiffs failed to state a claim under Rule 10b-5 against the principal corporate defendants, the question as to Morgan Stanley's liability as an alleged "accessory" was not specifically discussed. The complaint was dismissed as against all defendants.

The Court of Appeals' Opinion

The United States Court of Appeals for the Second Circuit affirmed the District Court's holding as to Morgan Stanley but reversed as to the corporate defendants.

Judge Medina, speaking for a divided Court, held that "a complaint alleges a claim under Rule 10b-5 when it

charges, in connection with a Delaware short-form merger, that the majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without justifiable business purpose." (Petition, at A-16) Thus the Court found that the amended complaint stated a claim under Rule 10b-5 against the corporate defendants, even though the Court conceded that there had been no misrepresentation and the state statutory procedure had been adhered to rigorously.

On the other hand, the Second Circuit held that plaintiffs' "summary allegations that the Company [Morgan Stanley] participated in fraudently undervaluing the minority shares fails to state a claim under Rule 10b-5." (*Id.*, at A-22) In so holding, Judge Medina first stated what elements are necessary to find a Rule 10b-5 violation in a Delaware short-form merger setting: (1) lack of a justifiable corporate purpose for the merger; (2) forced merger with no prior notice to the minority shareholders; and (3) breach of fiduciary duty. (*Id.*, at A-19) Significantly, the Court held that the allegation of substantial undervaluation, standing alone, does not make out a Rule 10b-5 case. (*Id.*, at A-18)

Judge Medina then explained why the amended complaint did not state a claim against Morgan Stanley as an "accessory" under Rule 10b-5. First, the Court found "no intimation in the amended complaint or in any of the briefs that Morgan Stanley & Co. had anything whatever to do with the planning of the merger or that it had any knowledge as to whether or not there existed a justifiable corporate purpose for the merger." (*Id.*, at A-19) Second, the Court stated that "Morgan Stanley & Co. cannot be, and has not been, charged with any responsibility for effectuating the procedural steps incidental to the merger

or for implementing the Delaware law and its provisions for shareholder notice after the merger has become effective." (*Id.*) Indeed, the Court noted Morgan Stanley's involvement in the merger to be "strictly limited to the valuation of stock and to the compilation of a report detailing the company's financial status." (*Id.*) Third, Judge Medina found it most important that Morgan Stanley "has not been charged with participation in the majority shareholders' breach of fiduciary duty, a key element of the latter's 10b-5 liability." (*Id.*) Moreover, the Court noted that it is not alleged that Morgan Stanley "received any benefit or unjustly profited in any direct or indirect manner by its appraisal." (Petition, at A-20)

Thus, based on the above findings, the Court held that the amended complaint failed to make out a claim against Morgan Stanley as an "accessory" or "aider and abettor" to the alleged Rule 10b-5 violation.

Judge Moore strongly dissented from the majority's holding that the amended complaint stated a claim against the primary corporate defendants. (*Id.*, at A-34-56) It was Judge Moore's opinion that deception still is a necessary element of a Rule 10b-5 action, and that the majority, in finding a Rule 10b-5 violation based upon breach of fiduciary duty, was creating a federal common law of corporations—an action seemingly in conflict with the Supreme Court's decision in *Erie R. Co.* v. *Tompkins*, 304 U.S. 64 (1938). Neither Judge Moore in his dissent, nor Judge Mansfield in his concurrence, even mentioned the issue now before the Court.

Following the panel's decision, Santa Fe petitioned the Second Circuit for a rehearing *en banc*. The plaintiff

herein did not seek rehearing *en banc* of the panel's affirmance of the District Court's dismissal of the complaint as to Morgan Stanley. The Second Circuit, in an opinion directed to this case and two others (the "Concord Fabric cases"), denied the requests for rehearing *en banc* stating its confidence that this Court would accept those three cases under its certiorari jurisdiction.* The issues presented to the Second Circuit by the requests for rehearing *en banc* by these three cases did not include the question now before this Court.

ARGUMENT

The Question Presented Is Not an Important Issue of Federal Law That Should Be Decided by This Court

Rule 19 of the Rules of the Supreme Court of the United States sets out the considerations governing review on certiorari. It states that certiorari will be granted "only where there are special and important reasons therefor." This requirement has been strictly interpreted by this Court. As Stern and Gressman point out: "The Court does not have time to give full consideration to all cases which present novel or interesting issues. It must necessarily confine itself to those which reflect the more important legal problems within the realm of its jurisdiction." R. Stern & E. Gressman, Supreme Court Practice 167 (4th ed. 1969).

The present issue before the Court merely represents an application of different allegations to well settled law. The

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* A petition for certiorari has been filed by the corporate defendants in this case.

law with regard to aiding and abetting liability under Rule 10b-5 has been well developed by the various circuit courts. To show that a party is an aider and abettor, the plaintiff must prove at a minimum: (1) the existence of an independent wrongful act; (2) knowledge by the aider and abettor of that wrongful act; and (3) substantial assistance by the aider and abettor in effecting that wrongful act. *See, e.g., Rochez Brothers, Inc.* v. *Rhoades*, 527 F.2d 880, 886-88 (3d Cir. 1975); *SEC* v. *Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); *Lanza* v. *Drexell & Co.*, 479 F.2d 1277, 1303 (2d Cir. 1973); *Brennan* v. *Midwestern United Life Ins. Co.*, 417 F.2d 147, 149-53 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

Applying these familiar principles, the Second Circuit was clearly correct in finding that plaintiffs' allegations do not state a claim as to Morgan Stanley. While the majority held that the amended complaint did state an independent wrongful act by the corporate defendants, plaintiffs failed to allege the existence of the other two elements necessary to state a cause of action against Morgan Stanley as an aider and abettor.

Thus, the amended complaint failed to allege the requisite knowledge on the part of Morgan Stanley. As the Court noted, there was no assertion that Morgan Stanley knew there was a lack of a valid corporate purpose for the merger. Since the Court of Appeals held that the lack of a valid corporate purpose for the merger is a key element in the alleged independent wrong committed by the primary defendants, a failure to allege knowledge of this fact by Morgan Stanley renders the complaint defective as against it.

Furthermore, the Court observed, and plaintiffs concede (Petition, at 13), that the amended complaint did not allege that Morgan Stanley was a principal in planning and making the merger. Most importantly, the Court held that the amended complaint did not charge Morgan Stanley with participation in the majority shareholder's alleged breach of fiduciary duty. In fact, plaintiffs admit that Morgan Stanley did not owe a fiduciary duty to the shareholders. (*Id.*) Since the essence of the Rule 10b-5 violation found by the Second Circuit is not deception or misrepresentation, but breach of fiduciary duty, the Court's conclusion of Morgan Stanley's failure to participate in that breach means that the amended complaint fails, in a second crucial respect, to state a cause of action against Morgan Stanley as an aider and abettor.

Thus, the aider and abettor issue presented by this case does not represent a "novel" or significant issue of law. This conclusion is perhaps best demonstrated by the fact that neither Judge Mansfield nor Judge Moore even discuss this question in their separate opinions.

Petitioner argues that a grant of certiorari is appropriate because, when the Court of Appeals rejected an *en banc* rehearing of this case and the Concord Fabric cases, it expressed the view that the three decisions were of "extraordinary importance." It is perfectly obvious that this characterization was not intended to embrace the aider and abettor issue; in fact, this issue was not even raised in the Concord Fabric cases or in the application for an *en banc* rehearing in this matter. The importance of these three cases is their holdings that, under the circumstances alleged, a Rule 10b-5 violation can be found without a claim of mis-

representation or deception. The aiding and abetting question presented here is merely tangential to that main issue and does not present any novel or important question for this Court's consideration.

There Is No Conflict Between the Second and Seventh Circuits

Contrary to petitioner's claim, the Seventh Circuit's holding in *Brennan* v. *Midwestern United Life Ins. Co.*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970), in no way conflicts with the Second Circuit's holding in the present case. In *Brennan* the Court held that the trial court was correct in finding that sufficient evidence had been introduced to substantiate the claims that the alleged aider and abettor: (1) knew that the primary violator was violating the Securities laws; (2) materially assisted him in doing so; and (3) had a substantial interest in the successful outcome of the violator's scheme. Here the Court of Appeals held that these elements were not present in the amended complaint as to Morgan Stanley.

As to knowledge, the Seventh Circuit found that the president and general counsel of the alleged aider and abettor ("Midwestern"):

> knew . . . that Dobich [the primary wrongdoer] was selling Midwestern Stock to his customers and that through one of his salesmen, he had made a number of misrepresentations. 417 F.2d at 150.

Therefore, Midwestern knew that a securities violation had been committed—it knew there had been misrepresentations made in connection with the sale of securities. Contrast this with the failure of plaintiffs in the present case to charge

Morgan Stanley with knowledge of the lack of a valid corporate purpose for the merger.

Secondly, as to substantial assistance, the Seventh Circuit found that Midwestern assisted the primary wrongdoer by direct contacts with the defrauded stockholders. Thus, the Court noted:

> With respect to complaints received from Dobich's customers after December 1, 1964, Midwestern followed a procedure which effectively foreclosed the possibility that complaining customers would proceed before the Indiana Securities Commission. Those who inquired about the delay in the delivery of their stock from Dobich were advised to first contact Dobich Securities. Some were further advised to proceed before the Indiana Securities Commissioner if a satisfactory explanation or delivery was not made by Dobich. Midwestern's letters were a signal to Dobich. They directed customers to contact Dobich and thus allowed him to arrange for delivery without fear of any Indiana Securities Commission interference. *Id.*, at 152-53.

In the case at bar, the allegation of fact is that Morgan Stanley provided an opinion to Santa Fe as to the price at which shares of Kirby would trade at if broadly distributed and freely traded; in marked contrast to *Brennan*, it is nowhere alleged that Morgan Stanley had any contacts whatsoever with any of the plaintiffs.

Finally, the Court in *Brennan* found that Midwestern had a substantial interest in assisting the primary wrongdoer in violating the security laws because Midwestern would profit if the merger at issue in that case were to be accomplished. (*Id.*, at 153) In contrast, as Judge Medina noted, plaintiffs

do not charge that Morgan Stanley "received any benefit or unjustly profited in any direct or indirect manner by its appraisal." (Petition, at A-20)

Thus, there is no conflict between the Seventh Circuit's holding in *Brennan* and the Second Circuit's holding in the present case. The holdings in these two cases merely represent the application of two entirely different fact situations to well settled principles of law.

With the realization that the issue of alleged primary wrongdoing in the present case and in the Concord Fabric cases presents this Court with important questions of law, respondent believes that the Court need not waste its time on a tangential issue that is by no means novel, and that is not the subject of conflict among the various Circuits.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this Petition for a writ of certiorari should be denied.

Dated: New York, New York
June 14, 1976

Respectfully submitted,

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